

Sales of "canned" computer software are taxable retail sales in Illinois regardless of the means of the delivery of that software. See 86 Ill. Adm. Code 130.1935. (This is a GIL.)

May 3, 2002

Dear Xxxxx:

This letter is in response to your letter dated March 1, 2002. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/Laws/regs/part1200/>.

In your letter, you have stated and made inquiry as follows:

We respectfully request an opinion regarding taxability to the following factual situations. The Department of Revenue issued a private letter ruling to our legal counsel on December 21, 1999, the original is enclosed. We have also enclosed our legal counsel's original letter for your convenience. Since the ruling was issued, we have become concerned about additional issues, and are also concerned about any changes in Illinois' tax law. Also enclosed are copies of the following software site license agreements: XX, XXX and XXXX.

We understand that should the facts as presented change, or do not reflect the essence of the transactions, your conclusions, as set forth in the ruling, may be open to redetermination.

I. Facts

Overview

AAA is a software developer. AAA develops software for the sole purpose of licensing the software to other entities in Illinois, other states within the United States, and foreign countries. The software is designed to facilitate individual stock trading on various national stock exchanges ('SOFTWARE'). Typically the SOFTWARE is licensed to a Broker/Dealer, which then allows the Broker/Dealer's customer ('End User') to use the SOFTWARE in one of two manners. The End User may use the SOFTWARE on a computer terminal located in the Broker/Dealer's office. Alternatively, the End User may download the software from the Broker/Dealer's website or under certain circumstances from AAA's website for use in End User's home or office.

AAA's offices are in STATE. AAA does not have any offices outside of STATE. Additionally, AAA has no employees other than those located in and working in STATE, except in the limited circumstances discussed below.

License Agreements

The license fee relative to the SOFTWARE is payable by the Broker/Dealer directly to AAA. The license fee is a fixed fee multiplied by the number of times the End User uses the SOFTWARE to place an order relative to a stock trade. No fee is charged for a canceled order.

The SOFTWARE is licensed pursuant to a software license entered into between AAA and the Broker/Dealer ('Site License'). The Site License typically has a term of one year subject to termination by either party on **sixty (60)** days notice. The Site License provides that AAA retains ownership of the code for the duration of the Site License and thereafter. Use of the software pursuant to a Site License by an End User must be in the Broker/Dealer's office (i.e. the site) and may not be by or through the Internet.

Under certain circumstances, a Broker/Dealer may enter into an amendment to the standard Site License with AAA to permit the End user to use the SOFTWARE through the Internet. If the Broker/Dealer enters into an Internet Amendment with AAA then each End User must enter into a Sublicense Agreement ('Sublicense') with respect to the End User's use of the SOFTWARE. The Sublicense is executed via point and click method on the Internet.

The software also possesses the capability to supply charts, graphs and analytics ('Analytic Software') to the individual End User. The license fee relative to the Analytic Software is a fixed monthly charge (i) for each workstation provided in the Broker/Dealer's office, payable by the Broker/Dealer directly to AAA, and (ii) for each End User of the Analytic Software provided to the End User via the Internet, payable by the End User directly to AAA.

The Site License Agreement and Internet Amendment (including Sublicense Agreement as Exhibit A to the Internet Amendment) Forms are attached as Exhibits 1 and 2 respectively. It is intended that all of the agreements be enforceable pursuant to the provisions of applicable STATE Law.

Sales and Installation

Software programs developed by AAA are advertised in trade publications, or will in the future be advertised in trade publications with national circulation, through direct mail and other multi-media campaigns. AAA's contact with customers occurs almost exclusively by telephone, mail and Internet from its offices in STATE. Except in limited circumstances, all software is shipped to the customer's location via common carrier, Internet or personally delivered by an employee of AAA.

Information Services

AAA provides Broker/Dealers direct access to the NASDAQ, NYSE, AMEX, and other exchanges. Third-party XYZ vendors provide this exchange information to AAA's order execution and charts and graphs systems. The XYZ vendors deliver the exchange information in a useable format.

There are complex compliance rules regarding access to exchange information and market data. As a convenience to our customers, AAA acts as a conveyor of this information. AAA's software, on an End User's workstation, accesses AAA's CITY servers where the real-time information is received and maintained. This may be done via the Internet or through a dedicated third-party telecommunications line. The real-time information is not software. It is not downloaded, or delivered in any way, to AAA's customers' computers. AAA's Broker/Dealer customers merely have the ability to view the information. The tool that they use to view this information is the SOFTWARE.

A typical AAA invoice separately states the Exchange Fees and XYZ from the software license fees. However, without the XYZ, the SOFTWARE would not function as intended. Likewise, exchange information and market data are not useful to End Users without some tool, such as our software, to view the information and execute trades. While it is possible for an End User to access exchange information and market data independent of AAA, to date it has not happened.

II. Questions

Please provide a ruling on the following 'items:

1. Nexus:

- A. AAA only has a few licensed customers in Illinois. In *Quill Corp. v. North Dakota*, 112 S. Ct. 1904, the physical presence of only a few licensed floppy diskettes in a state did not constitute a sufficient presence in that state to create sales or use tax nexus. Has Illinois established a physical presence standard relative to *Quill*?
- B. If all of AAA's Illinois customers received the licensed software exclusively via Internet download, would AAA have nexus in Illinois?
- C. AAA sometimes provides its customers with computer hardware. For AAA's non-Internet customers, the company evaluates whether its larger customers require quote servers or routers and provides them where necessary. AAA provides other customers with hardware, i.e. a 'NAME,' which attaches to their computer and tallies the number of quotes or trades. All of this equipment remains AAA's property and will physically revert to AAA should the customer cancel his license. Does providing this hardware establish a significant presence resulting in nexus?

- D. Will AAA establish nexus if an employee, based in STATE, with no authority to propose or negotiate sales:
 - a. Occasionally travels to Illinois to provide technical support services for a licensee (Broker/Dealer) located in Illinois pursuant to the Site License?
 - b. Frequently travels to Illinois to provide technical support services for a licensee (Broker/Dealer) located in Illinois pursuant to the Site License?
- E. Will AAA establish nexus if an employee, based in STATE, with no authority to propose or negotiate sales:
 - a. Occasionally travels to Illinois to install SOFTWARE a licensee's (Broker/Dealer) computer hardware under a Site License?
 - b. Frequently travels to Illinois to install SOFTWARE on a licensee's (Broker/Dealer) computer hardware under a Site License?
- F. Will AAA establish nexus if an employee, based in STATE:
 - a. Occasionally travels to Illinois to solicit customers (sales calls, proposals, etc.) or take sales orders?
 - b. Frequently travels to Illinois to solicit customers (sales calls, proposals, etc.) or take sales orders?

2. *License Fees:*

- A. Are software license fees for non-customized software, which are delivered via a tangible medium (i.e. CD-ROM), subject to the sales or use tax?
- B. Are software license fees for non-customized software, which are digitally delivered via the Internet, subject to the sales or use tax?
 - a. As described in the '*Information Services*' section, if AAA provides a quote server (physical computer hardware), which parses the raw data and accepts requests from the SOFTWARE, does this change the intangible nature of the downloaded software license fees?
 - b. Typically, customers access real-time quotes via third party telecommunications lines from their location to our CITY-based servers. Are electronic information services subject to the tax and does this effect the electronically delivered software license fees?

- C. Does AAA have tax collection responsibilities for software licenses where our Broker/Dealer customer sublicenses the SOFTWARE to an End User? Specifically, can our customer issue us a resale certificate for the SOFTWARE and collect the tax, where applicable, from their customers?

3. *Information Services:*

Which of the following revenue items are subject to the sales or use tax?

- A. CCC Fee: 'CCC' is a specific NETWORK. A NETWORK enables traders, market makers, and institutions to display their bids or offers and thereby make a market on NASDAQ stocks. The fee is paid by the Broker/Dealer for the integrated CCC book, which combines four levels of CCC book quotes. The End User accesses the CCC electronically on AAA's CITY based servers.
- B. Exchange Fee: A direct pass-through of the amount charged by the various financial exchanges for their exchange information. The End User submits a request for the specific exchange from which it wants information. A third-party carrier (XYZ vendor) provides the exchange information. AAA passes through the amount the exchange charges for the information.
- C. XYZ: These are pass-through charges from vendors that provide the exchange information. Presently, a typical AAA invoice combines the XYZ with the license fee charged directly to the Broker/Dealer for their Internet users' access to AAA's order execution and charts and graphs software. Are the XYZ considered a taxable service as a stand alone revenue item? If not, are the XYZ charges taxable when lumped together with the license fee revenue items?
- D. Charts & Graphs Fee: License fee for the use of AAA's charts and graphs system used at the Broker/Dealer's office. This system graphically depicts the market's status in real-time. The fee is charged per terminal.
- E. Internet Workstation Fee: License fee charged directly to the Broker/Dealer for their Internet users' access to AAA's order entry and charts and graphs system. The license fee includes a non-itemized pass-through of the XYZ costs.

4. *Miscellaneous Fees:*

The following are descriptions of other services that AAA offers to its customers and how they are billed. Please indicate whether these items are subject to the sales or use tax.

- A. Order Fee: This is a nominal fee charged for each order, which does not include a cancelled order, placed through AAA's order entry system by a user in the

Broker/Dealer's office or via a dial-in arrangement (this does not include Internet users).

- B. Internet Order Fee: Nominal fee charged for each order, which does not include a cancelled order, placed through AAA's order entry system via the Internet by the Broker/Dealer's End User, not located in the Broker/Dealer's office.
- C. Minimum Order Fee: The cumulative minimum Order Fees required to be paid by the Broker/Dealer each month. The amount due is calculated by subtracting the actual Order Fees from the minimum Order Fee set forth in the contract with the Broker/Dealer. If the Broker/Dealer's actual Order Fees exceed the Minimum Order Fee, then no Minimum Order Fee is due. In this case the Broker/Dealer pays the actual fee.
- D. Contract Change Fee: Fee charged for the modification of licensing agreements or contracts.
- E. Late Count Charge: Fee charged for a Broker/Dealer's failure to upload trade count information to a Server as required pursuant to the Broker/Dealers contract.
- F. Late Fee: Fee charged for late payment of bill. We believe that the taxability of the Late Fee is contingent upon the taxability of the revenue item upon which it relates.
- G. Administrative Fee: \$ per user for reporting and keeping track of information to the exchanges.
- H. ABC Fee: This is a license fee charged for the use of AAA's reconciler program that consolidates Broker/Dealer accounts at the end of each day and submits them to the appropriate clearing firm.
- I. Installation Fee: This is a one-time fee charged to AAA xxx customers for setting up their account, the software, and the hardware and ranges from \$00 to \$00.
- J. Communication Fee: This is a direct pass through of the amount charged by various telecommunication vendors for AAA customers' connectivity to the AAA servers.

Resale Certificates:

In some instances, Broker/Dealers sublicense the SOFTWARE to their customers. These Broker/Dealers download the SOFTWARE from AAA's Internet website and maintain a copy on their servers. The Broker/Dealers do not use the SOFTWARE to execute trades; instead, they sublicense the software to their customers ('End Users').

The Broker/Dealers will either provide a copy of the software to their End Users, or the End Users will access the software at the Broker/Dealers' physical location. In either case, the Broker/Dealers invoice their End Users for the service. In this case, where is the taxable incident? Should the Broker/Dealers issue AAA a resale certificate and collect the sales or use tax from their customers?

We respectfully request that you opine as to the issues presented herein. If you have any questions or want to discuss these matters in more detail, please call me.

DEPARTMENT'S RESPONSE

Nexus:

In the context of a General Information Letter, the Department is unable to make nexus determinations because the amount of information required to make that determination is often best gathered by an auditor. The following information outlines the principles of nexus. We hope it is helpful to you in determining whether you are responsible to pay tax in Illinois.

An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i), enclosed. This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801, enclosed. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The United States Supreme Court in Quill Corp. v. North Dakota, 112 S. Ct. 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. Quill at 1910.

The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative. Any type of physical presence in the State of Illinois, including the vendor's delivery and installation of his product on a repetitive basis, will trigger Use Tax collection responsibilities. Please refer to Brown's Furniture, Inc. v. Zehnder,

(1996), 171 Ill.2d 410.

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax on the purchase of the out-of-State goods and have a duty to self-assess their Use Tax liability and remit the amount directly to the State.

In reference to your inquiry regarding software downloaded over the Internet, the transfer or sale of canned computer software downloaded electronically would be taxable. Generally, canned computer software transferred or downloaded electronically in this State by itself would not meet the physical presence requirement of the Quill case. However, the presence of the employees described in your letter (regardless of whether those employees have authority to propose or negotiate sales) meets the physical presence requirement of the Quill case. Please note also that any tangible personal property, such as computer hardware, that is used in this State is subject to Illinois Use Tax liability. Illinois does provide a Use Tax credit for taxes properly due and paid in another state. See 86 Ill. Adm. Code 150.310. In addition, depreciation is allowed for any out-of-State use. See 86 Ill. Adm. Code 150.110.

We cannot provide you with any specific answers as to how often an employee or employees can travel to Illinois before the physical presence require under Quill has been reached. As noted above, employees, agents, or other representatives also need not be sales representatives to still be considered to meet the physical presence requirements for nexus. Any type of physical presence in the State of Illinois, including the vendor's personnel involved in the delivery and installation of his product on a repetitive basis, will trigger Use Tax collection responsibilities. Please see Brown's Furniture, Inc. v. Zehnder, 171 Ill.2d 410 (1996).¹

License Fees:

Sales of "canned" computer software are taxable retail sales in Illinois regardless of the means of the delivery of that software. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See subsection (c) of the enclosed copy of 86 Ill. Adm. Code 130.1935.

Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See subsection (c)(3) of Section 130.1935.

If transactions for the licensing of computer software meet all of the criteria provided in subsection (a)(1) of Section 130.1935, neither the transfer of the software or the subsequent software

¹ In Brown's Furniture, Inc. v. Zehnder, the Illinois Supreme Court held that making 942 delivery trips in the state (during a 10 month period) will subject a company to use tax collection responsibilities.

updates will be subject to Retailers' Occupation Tax. Software licenses are not subject to tax regardless of whether they are transferred through tangible means, such as a disk, or by electronic means (downloaded etc.).

A license of software is not a taxable retail sale if:

- A) It is evidenced by a written agreement signed by the licensor and the customer;
- B) It restricts the customer's duplication and use of the software;
- C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;
- D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and
- E) The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under subsection (c) of Section 130.1935, they may not be taxable. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreement would be taxable as sales of canned software.

Persons who are transferring canned software to a purchaser who intends to resell that software may accept a certificate of resale from that purchaser. Persons who are transferring custom software or nontaxable licenses of software as described above to persons who intends to resell that custom software or sublicense the software do not incur tax and are not required to obtain certificates of resale from their purchasers.

Information Services & Miscellaneous Fees:

Generally, information that is downloaded is generally not taxable because it is considered an intangible. The Department recently amended 86 Ill. Adm. Code 130.2105 (copy enclosed) to read, in part, as follows:

"Information or data that is downloaded electronically, such as downloaded books, musical recordings, newspapers or magazines, does not constitute the transfer of tangible personal property. These types of transactions represent the transfer of

intangibles and are thus not subject to Retailers' Occupation and Use Tax. However, downloads of canned software, as defined more fully in Section 130.1935 of this Part, are subject to Retailers' Occupation and Use Tax."

However, if you transfer such information in a tangible format, such as on tape or disk, such transfer is taxable as either a Retailers' Occupation Tax or a Service Occupation Tax transaction depending on whether the item is customized.

The specific nature of the various fees you have listed is not clear, and we cannot provide you with specific answers regarding those fees. Generally, if they are not fees for software (see above), or do not involve the transfer of tangible personal property, those fees are not generally subject to tax in Illinois.

Resale Certificates:

As noted previously, persons who are transferring canned software to a purchaser who intends to resell that software may accept a certificate of resale from that purchaser. Persons who are transferring custom software or nontaxable licenses of software as described above to persons who intends to resell that custom software or sublicense the software do not incur tax and are not required to get certificates of resale from their purchasers. If you are unsure whether the sale of software or a license of software is subject to tax and the purchaser intends to resell or sublicense that software, you may want to get a certificate of resale from the purchaser to avoid any potential liability for tax, penalty, and interest that may be incurred if that sale is latter determined to be a sale of taxable canned software.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b) described above.

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
Enc.